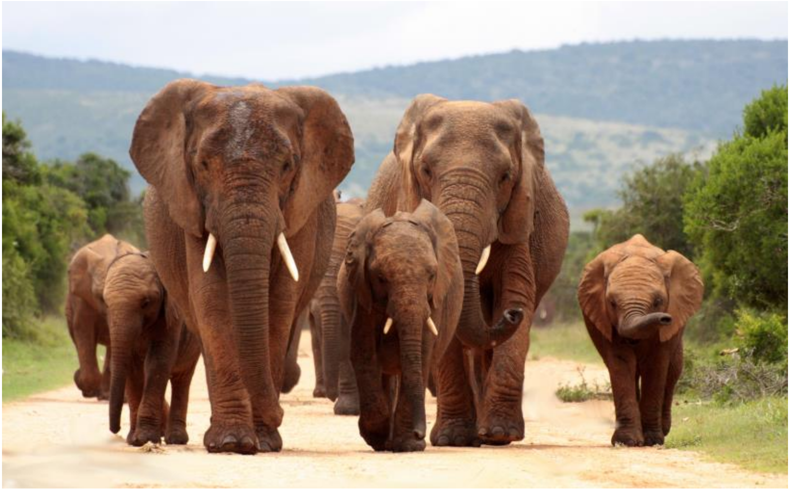
Taxation of Trusts in Israel- Looking Ahead



Implications for grantors and trustees of trusts with Israeli beneficiaries

Broide & Co.

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Taxation of trusts in Israel

Classification of Trusts

The Laws governing taxation of trusts in Israel came into effect as of January 2006. More recent legislation – effective as of 2014 – includes the taxation of foreign-settled trusts in Israel, where the trust has Israeli-resident beneficiaries, subject to certain exceptions.

The donor/transferor of assets to the trust is also considered a settlor/grantor (this refers to the economic settlor). There may be more than one settlor/grantor. The definition includes a beneficiary where able to exercise direct or indirect control of the trust.

A family trust (close family relationship between settlor/grantor and beneficiaries) is defined in the Law and is also conditional on the settlor or spouse being alive.

Where the trust is fully irrevocable/discretionary – as defined – then where all the beneficiaries are foreign, the income of the trust will not be taxable in Israel, subject to various conditions. There is a provision for taxing only that part of the trust income that relates to Israeli-resident beneficiaries, but the ITA contests this approach.

On the death of the settlor/grantor, where there is an Israeli-resident beneficiary, the trust will be considered an Israeli-resident trust.

A trust settled by a new immigrant/resident is entitled to certain Income Tax benefits ("the 10-year tax holiday") available to the settlor/grantor; new residents who became resident from August 1, 2013, will be subject to certain limitations.

Income Tax Factors

1. Rates of tax on passive income of the trust will generally be 25%.

2. Trustees of family trusts may elect to be taxed at 25% of the taxable income of the trust or 30% on distributions (with allowance for neutralizing the capital contributed). This election is irreversible. A tax surcharge of 3% is levied on taxable income exceeding the ceiling as defined.

3. Foreign taxes paid on trust income by the trust\grantor\beneficiary can be used as foreign tax credit in Israel. In many cases US trusts reporting in Israel have no additional taxes to pay.

"The hardest thing in the world to understand is the income tax."–**Albert Einstein**

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4. The residence of the trustees will not impact on the taxability of the trust.

5. Underlying companies, (holding trust assets and fully owned by the trust), will generally be treated as part of the trust structure and taxed accordingly (subject to certain conditions).

6. Dissolution of existing trusts may have tax consequences.

7. Beneficiaries are required to report on distributions received in kind or cash, and irrespective of whether taxable. Most beneficiaries are required to submit annual tax returns.

General Points

An arrangement, whereby a trustee holds assets for a beneficiary, may be defined as a trust, even where not formally established under Trust Law, locally or abroad.

Under certain conditions, the settlor/grantor may report to the Tax Authority (and thus be the taxable entity) and not the trustees.

Where the beneficiaries of a foreign-settled charitable trust are public institutions – as defined – then they will retain their foreign status.

There is not always full clarity nor certainty in the approach of the ITA to taxation and reporting of trusts in Israel. This should be born in mind.

10-Year "Tax Holiday" Overview

10 year "tax holiday" is available to new immigrants and to returning residents who lived at least 10 years outside of Israel.

Passive income from foreign assets is tax exempt and not reportable.

There are planning opportunities during the 10-year period:

- Freedom to create, change or cancel
- Serious planning before the end of the 10-year period

Israeli Tax Filing - Points to Consider

- U.S. charitable contributions – subject to certain limitations, can be reported – will generate a 35% tax credit. This does not apply to trusts and foundations.
- State taxes can be used as a foreign tax credit.
- It is important to ensure your Israeli CPA/tax advisor as well as your US tax professionals are aware of the specific issues related to Israel-US taxes.

Trusts with Israeli Beneficiaries

Does your trust have any Israeli beneficiaries? Major tax changes affect foreign trusts

Since 1/1/2006 trusts that had Israeli resident settlors/grantors have been subject to Israeli taxation and reporting, while foreign settlor/grantor trusts were generally not taxable. Since January 1, 2014, foreign settlor/grantor trusts that have an Israeli tax resident beneficiary are subject to Israeli taxation and reporting. The Israeli Beneficiary Trust (IBT) is subject to the reporting and taxation "portion" to be attributed to the Israeli beneficiaries; trusts are required to report their underlying companies (as defined in the law) which are taxable at trust tax rates.

There are two types of IBTs:

1. **Family/Relatives Trust** – where the settlor or his spouse are alive, and in which settlor/grantor and beneficiaries are close family relatives, may elect to be taxed annually at 25% of taxable income or on distributions at a 30% rate (capital portion exempt).
2. **Non Family/Relatives Trusts** – in which settlor/grantor and beneficiaries are not relatives, will be taxed annually at regular individual rates.

Trustees of IBTs are now required to:

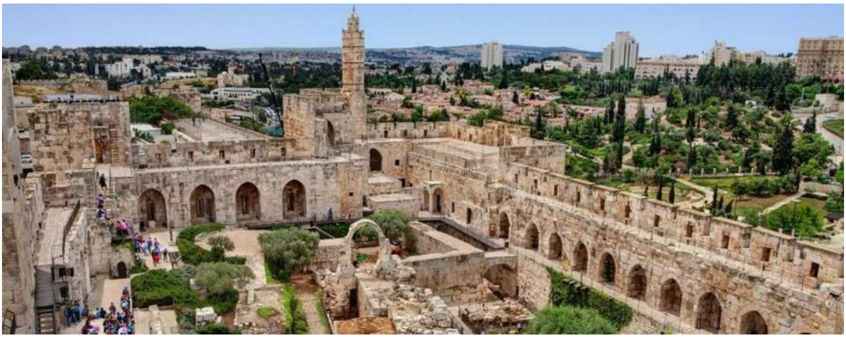
1. Open a tax file for each IBT and disclose its assets
2. Elect the preferred tax route (annual/upon distribution)
3. Sign and submit annual tax returns (annual tax route)
4. Report and pay taxes upon distributions (distribution tax route)

Important notes for trustees:

1. Trustees should obtain documentation as to the value of the trust's assets at registration.
2. Where possible trustees should prepare a schedule with a breakdown of the original trust capital and the profits.
3. Obtain a schedule (and documentation) of taxes paid on trust income (by trust, beneficiaries, and underlying companies).
4. All distributions as of August 1, 2013, are reportable by recipients

Disclaimer

This tax overview is prepared for the information of clients and associates Whilst every care has been taken in compilation, no responsibility can be accepted for inaccuracies or errors. Clients are also advised that changes i the Law or practice occur periodically; it is recommended that specific professional advice be sought before any action is taken.



Contact Us

Address: Emek Refaim 43A, German Colony,

Jerusalem 9108102

Phone: 02-5611323
Fax: 02-5669555
Email: dvora@broide.com
Web: www.broide.com

BROIDE & CO.
Certified Public Accountants (Isr.)

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